

VU Research Portal

'White-collar crime and European financial crises: getting tough on EU market abuse' selected for reprint in European Current Law

Herlin Karnell, S.E.M.

published in
European Current Law
2012

[Link to publication in VU Research Portal](#)

citation for published version (APA)

Herlin Karnell, S. E. M. (2012). 'White-collar crime and European financial crises: getting tough on EU market abuse' selected for reprint in European Current Law. *European Current Law*, 2012(10), 11.

General rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal ?

Take down policy

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

E-mail address:
vuresearchportal.ub@vu.nl

Focus

WHITE-COLLAR CRIME AND EUROPEAN FINANCIAL CRISES: GETTING TOUGH ON EU MARKET ABUSE¹

Ester Herlin-Karnell²
VU University of Amsterdam

Abstract

The proposed Directive on criminal law sanctions against insider dealing and market manipulation (referred to as market abuse) offers the first test case of the boundaries of the new criminal law competence provision of art.83(2) TFEU. The proposed Directive is accompanied by a proposal for a Regulation, based on art.114 TFEU, which also aims to fight market abuse albeit by the use of administrative sanctions. This contribution considers the feasibility of the current EU regime against market abuse and thereby discusses the legal basis of the proposed instruments as well as delicate questions raised by these measures.

Introduction

The Commission's recent proposal for a Directive³ on criminal sanctions for insider dealing and market manipulation (referred to as market abuse) offers the first example of use of art.83(2) TFEU, the "extended" competence clause for "harmonisation" of an area which is essential for the effective implementation of EU law and where harmonisation measures have already been adopted. The rationale for the proposed Directive, which is to be read in conjunction with the proposed Regulation⁴ on insider dealing and market manipulation, is to ensure market integrity and enhance public confidence in securities and derivatives. The measures will, if adopted, supersede the 2003 Market Abuse Directive (MAD).⁵

The proposed instruments raise some intriguing issues. First, the question arises as to the feasibility of criminal law to secure the integrity of the market at all. Secondly, the issue of the adequacy of the legal basis for the proposed instruments as well as the desirability of double measures in this area needs to be considered. And, thirdly, the issue of fundamental rights protection and the increased preventive focus as witnessed particularly with regard to the Regulation and its far-reaching requirements for the Member States to have surveillance mechanisms in place must be addressed.

What is groundbreaking with respect to the initiatives is that the proposed Directive creates a new framework for the purposes of fighting crime while it regroups the previous MAD regime into a separate Regulation to increase the effectiveness of the system. The proposed Directive is a prime example of the invocation of criminal law to guarantee effectiveness of European policies in this area. This reflection piece will discuss the legal basis of the proposed Directive and Regulation. In addition, the article considers the desirability of double measures, that is, both a Directive and a Regulation

¹ The article was first produced by Thomson Reuters (Professional) UK Limited *European Law Review*, (2012) 37 E.L. Rev. 481

² University Lecturer in EU law, Centre for European Legal Studies and Faculty of Law. Thanks go to Prof Niamh Nic Shuibhne and Prof Gareth Davies for helpful comments on this article, with the usual disclaimer.

³ *Proposal for a Directive on criminal sanctions for insider dealing and market manipulation* COM(2011) 654 final.

⁴ *Proposal for a Regulation on insider dealing and market manipulation* COM(2011) 651 final.

⁵ Directive 2003/6 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16.

aimed at the same goal to fight irregularities in the market in order to increase market integrity in this area.

The article will proceed as follows. After a very brief reiteration of the main changes brought about by the Lisbon Treaty and the previous lack of criminal law competence in the European Union, the article discusses the history of the EU legislative framework against market manipulation and insider dealing. The article then moves on to look at the peculiarities of the new competence in art.83(2) TFEU and the question of when harmonisation of criminal law is needed for the effective implementation of EU law. Subsequently, the article investigates the proposed Regulation and discusses delicate questions raised by this instrument with regard to fair trial guarantees. The article then turns to the Commission's recent communication on the coherence and effectiveness of European criminal law and asks to what extent the Commission lives up to this promise in the proposed measures under consideration.⁶

Financial crimes and EU law

The proposed Directive and Regulation were not created in a vacuum but should be seen in the light of the history of the debate on the market abuse regime and the question as to why the suppression of financial crimes is relevant in EU law. Indeed, financial crimes together with organised crime have since the early days of the European Union constituted the main criminal law threat to the establishment of the internal market and have, until 9/11 when the fight against terrorism became a higher priority, formed the core of the European Union's approach to criminal law.⁷ After all, criminal law was not really of interest for the EU legislator unless it was needed as a tool for managing the internal market. Added to this, there was of course no explicit supranational legislative competence for the European Union in criminal law matters prior to the Lisbon Treaty. Yet, given the economic nature of the internal market, it was often argued that the fight against financial crimes was a legitimate objective for the European Union even before the extended competences granted by the Lisbon Treaty.⁸

The fight against EU financial crimes has traditionally taken place within the framework of the market creation provision of art.114 TFEU where the aim has been to increase investor confidence. Through this legal web, the European Union relied on administrative sanctions in the suppression of, for example, money laundering and the financing of terrorism.⁹ Nevertheless, the Tampere Conclusions of 1999,¹⁰ the outcome of a special summit held by the European Council devoted to Justice and Home Affairs issues,¹¹ had already underlined the necessity of taking action more fiercely within the financial crime sphere by singling out money laundering and corruption as crimes deserving special attention at EU level. This objective was later taken a step further with the Stockholm Programme,¹² which seeks to improve the prosecution of tax evasion and corruption in the private sector and the early detection of fraudulent market abuse as well as the misappropriation of funds.

The Stockholm Programme is the most recently adopted Justice and Home Affairs agenda. It represents an important step in the direction of "more" criminal law at EU level and should be viewed in the context of the entry into force of the Lisbon Treaty, through which the question of EU criminal law competences was partially solved. Criminal law as a European policy area forms part of the Area of Freedom, Security and Justice (AFSJ) chapter in Title V of the TFEU. Of particular importance here is art.83(1) TFEU, which concerns the regulation of substantive criminal law and stipulates that the European Parliament and the Council may establish minimum rules in directives concerning the definition of criminal law offences and sanctions in the area of particularly serious crime with a cross-border dimension resulting from the nature or impact of such offences or from

⁶ Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law COM (2011) 573 final.

⁷ See e.g. S. Peers, *EU Justice and Home Affairs* (Oxford: Oxford University Press, 2011), Ch.1.

⁸ See e.g. A. Sherloch and C. Harding, "Controlling Fraud within the EC" (1991) 16 E.L. Rev. 21; J. Vervaele, *Fraud against the Community* (Kluwer Law International, 1992); S. White, *Protection of the Financial Interests of the European Communities* (Kluwer Law International, 1998); H. Xantaki, "Fraud in the EU: Review of Olaf's Regulatory Framework" in I. Bantekas and G. Keramides (eds), *International and European Financial Criminal Law* (Butterworths, 2006), p.305.

⁹ See Directive 2001/97 amending Directive 91/308 on the prevention of the use of the financial system for the purpose of money laundering [2001] OJ L344/76. And more recently, Directive 2005/60 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing [2005] OJ L309/15.

¹⁰ European Council Tampere 1999.

¹¹ On the Tampere Conclusions, see Peers, *EU Justice and Home Affairs* (2011), pp.18-19.

¹² "The Stockholm programme—An open and secure Europe serving and protecting the citizen" (Brussels: Council of the European Union, December 2, 2009), <http://register.consilium.europa.eu/pdf/en/09/st17/st17024.en09.pdf> [Accessed July 5, 2012].

a special need to combat them on a common basis. Thereafter, this provision sets out a list of crimes in respect of which the European Union shall have legislative competence such as terrorism, organised crime, and money laundering, counterfeiting of means of payment and computer related crime. It also states that the Council may identify other possible areas of crime that meet the cross-border and seriousness criteria. Furthermore, art.83(2) establishes that the possibility exists for approximation of national laws if a measure proves essential towards ensuring the effective implementation of a Union policy in an area that has already been subject to harmonisation measures.

Yet despite the entry into force of the Lisbon Treaty and thereby the extended competences in EU criminal law, there is no explicit legal basis for the fight against market abuse in general since the European Union's competence is limited to specific areas and is a shared competence (art.4(j) TFEU). Although "market abuse" is not listed in art.83(1) TFEU, such misconduct could, however, often be linked to organised crime or, with some imagination and by overstressing legality, "computer related criminality" or "fraud". Nevertheless, as mentioned, the proposed Directive is based on art.83(2) TFEU and the need to harmonise in order to ensure the effective implementation of a Union area. Before examining the justification of the proposed measures under scrutiny here, it is useful briefly to outline the history of the European Union's fight against market abuse as such.

A MAD history

Market abuse is the umbrella label used to define insider dealing and market manipulation. The definition of market manipulation is somewhat vague. In short, it may arise in circumstances where investors have been unreasonably disadvantaged, directly or indirectly, by others who have used information which is not publicly available to trade in financial instruments to their advantage (insider dealing), have distorted the price-setting mechanism of financial instruments, or have disseminated false or misleading information.¹³ Similarly to the European Union's fight against money laundering and the financing of terrorism, there have been concerns raised about lack of clarity and undermined human rights standards in this area.¹⁴

Consequently, the merits of the existing Market Abuse Directive (MAD) have been intensely debated.¹⁵ The initial MAD was adopted in 2003 and introduced a comprehensive framework to tackle insider dealing and to boost investor confidence in the market by prohibiting those who possess inside information from trading in related financial instruments. The MAD was revolutionary since it addressed market manipulation and insider dealing in the same measure as market abuse related misconduct. The ban on insider dealing in modern European law has its roots in the United States, where the courts developed it based on the general common law provisions on fraud.¹⁶ The debate in connection with the 2003 Directive was centred on the question of whether the "confidence in the market" slogan fitted with art.114 TFEU and how the fight against market abuse could be linked to it. The problem was that the MAD, according to commentators, was not really aimed at market making as such despite being based on art.114 TFEU. Hence the prohibition of market abuse aimed to protect market efficiency in general.¹⁷ So the burning issue here has been if market abuse distorts the market at all.¹⁸ Some commentators, such as Ferrarini, pointed out that the Directive was not ambitious enough as the EU legislator simply stated that the prevention at stake could not be sufficiently achieved by the Member States and could therefore by reason of its scale and effects be better achieved at EU level.¹⁹ In short, the main source of criticism has been that there have been shortages in sophisticated arguments as presented by the

¹³ See the vague definition as provided in the *Proposal for a Directive on criminal sanctions for insider dealing and market manipulation* COM(2011) 654 final. See also M. Siems and M. Nelemans, "The Reform of the Market Abuse Law: Revolution or Evolution?" (2012) 19 *Maastricht Journal of European and Comparative Law* 195.

¹⁴ R. Alexander, *Insider Dealing and Money Laundering in the EU: Law and Regulation* (Aldershot: Ashgate, 2007), p.145.

¹⁵ e.g. N. Moloney, "Investor protection and the Treaty" in G. Ferrarini et al. (eds), *Capital Markets in the Age of the Euro* (The Hague: Kluwer Law, 2003), p.17.

¹⁶ E. Engle, "Global norm convergence: capital market in US and EU law" (2010) 21 *E.B.L. Rev.* 465.

¹⁷ G. Ferrarini, "The Market Abuse Directive" (2004) 41 *C.M.L. Rev.* 711.

¹⁸ E. Herlin-Karnell, "Is there more to it than the fight against Dirty Money? Article 95 and the criminal law" (2008) 19 *E.B.L. Rev.* 558.

¹⁹ Ferrarini, "The Market Abuse Directive" (2004) 41 *C.M.L. Rev.* 711.

Commission. As pointed out by Moloney, investor confidence in the marketplace is notoriously difficult to pin down and the exact losses hard to estimate.²⁰

In any case, as a result of the global economic crises, concerns were raised about the effectiveness of the MAD and the need to update it in the light of current circumstances. Clearly, the financial crises appear to be a trigger of policy reforms in this area. The development of the European Union's fight against irregularities and criminal activity in the financial sector should therefore be seen in tandem with the European Union's desperate attempts to recover the economy by boosting investor confidence in the EU market. The High-Level Group on Financial Supervision was set up to strengthen European supervisory arrangements covering all financial sectors, with the objective of establishing a more efficient, integrated and sustainable European system of supervision strengthening European supervisory arrangements covering all financial sectors.²¹ This Group recommended that "a sound prudential and conduct of business framework for the financial sector must rest on strong supervisory and sanctioning regimes".²² This recommendation was issued at the same time as the importance of the efficient functioning of the MAD was underlined by the Commission's Communication "Driving European recovery".²³ In this Communication, the Commission referred to the High-Level Group, which stressed the importance of confidence, which was taken for granted in well-functioning financial systems but had been lost in the present crisis.²⁴ Therefore the reorganisation of this system focused on the importance of the enhancement of market integrity and investor protection where the reformation of the sanctions system was seen as a crucial part of this strategy.²⁵

In other words, the reform of the market abuse regime forms part of the broader rescue mission to "save Europe", where the financial sector and the global economy have been victims of misconducts within the financial sector.²⁶ For this reason, there is in the view of the Commission an urgent need to get tough on EU market abuse.

The proposed Directive on criminal sanctions for insider dealing and market manipulation

As explained, the proposal for the Directive on criminal sanctions for insider dealing and market manipulation (market abuse) forms part of the general reshuffle spirit in the European Union in order to increase confidence in the market and thereby boost trust and increase economic activity. The purpose of the Directive seems to be to move closer to the objective of a single rulebook.²⁷ More specifically, according to the Commission, the adoption of administrative sanctions in combination with the divergent approaches in the Member States has proved insufficient. Thus something needs to be done to increase the effectiveness of the regime and boost investor confidence. Could criminal law offer that magic solution?

The proposed Directive is based on art.83(2) TFEU, which, as noted, provides for a more extensive competence than the areas listed in art.83(1) TFEU for the effective implementation of a Union policy. The proposed Directive states that the MAD system has proved insufficient, that supervisory authorities must be equipped with sufficient powers, and that the Member States' sanctioning regimes are generally regarded as weak and heterogeneous. According to the Commission, market abuse can be carried out across borders and this divergence undermines the internal market and leaves a certain scope for the perpetrators of market abuse to carry out such abuse in jurisdictions which do not provide for criminal sanctions for a particular offence. The

²⁰ N. Moloney, *EC Securities Regulation* (Oxford: Oxford University Press, 2008), Ch.12, for an extensive discussion of the MAD with references.

²¹ See "The High-Level Group on Financial Supervision in the EU" (February 25, 2009), <http://ec.europa.eu/internalmarket/finances/docs/delarosierereporten.pdf> [Accessed July 5, 2012].

²² "The High-Level Group on Financial Supervision in the EU" (February 25, 2009), p.23, <http://ec.europa.eu/internalmarket/finances/docs/delarosierereporten.pdf> [Accessed July 5, 2012].

²³ COM(2009) 114 final.

²⁴ "The High-Level Group on Financial Supervision in the EU" (February 25, 2009), <http://ec.europa.eu/internalmarket/finances/docs/delarosierereporten.pdf> [Accessed July 5, 2012].

²⁵ *Proposal for a Directive on criminal sanctions for insider dealing and market manipulation* COM(2011) 654 final.

²⁶ P. Hardouin, "The aftermath of the financial crises. Poor compliance and new risks for the integrity of the financial sector" (2011) 18 *Journal of Financial Crime* 148.

²⁷ See Commission Staff Working Paper, "Impact assessment accompanying the proposals for a Regulation and a Directive on market abuse" SEC(2011) 1217 final, available at <http://ec.europa.eu/internalmarket/securities/docs/abuse/SEC2011.1217.en.pdf> [Accessed July 16, 2012]. See also more generally, N. Moloney, "EU Financial market regulation after the global financial crises: More Europe or more risks?" (2010) 47 *C.M.L. Rev.* 1317.

proposed Directive wants to change this by adding criminal law to the discussion and thereby fighting market abuse more effectively.

Hence the proposed Directive offers a test case on the limits of art.83(2) TFEU, and on how much can slip through this provision and its requirement that harmonisation is needed since there is not much in contemporary EU law that has not already been the subject of some kind of harmonisation by the European Union and could therefore *not* be linked to the effectiveness criteria as stipulated in this provision. As noted above, art.83(2) TFEU provides for a broader competence in an area that has already been subject to the European Union's harmonisation programme if it were essential for the effective implementation of a Union policy. Arguably, this paragraph has to be read in the light of the famous, albeit controversial, *Commission v Council (Environmental crimes)* ruling in 2005, where the court held that (environmental) criminal law could be harmonised for the full effectiveness of EU law in order to ensure effective, proportionate and dissuasive penalties.²⁸

Nevertheless, the proposed Directive does not rely on classic effectiveness concerns. Rather, it argues that criminal sanctions to fight market manipulation and insider dealing are needed as a tool for the smooth functioning of the internal market and, in particular, to ensure market integrity. Yet the problem is that the Commission does not define market integrity, though the Directive turns on it. Commonly, the term market integrity is negatively defined as "the extent to which investors engage in prohibited trading behaviour".²⁹ The difficulty is, however, that the absence of abuse does not necessarily lead to integrity. Still, the need to ensure integrity in the market seems inexorably linked to the question of confidence in the market.

What is unclear is why the proposal is based on art.83(2) TFEU and not art.114 TFEU governing the internal market. Although it is true that art.114 TFEU is residual to other specific legal bases, it could be argued that art.114 TFEU would have been a more appropriate legal basis here. There is at least one reason for this: an interpretation of art.83(2) TFEU with no threshold at all in terms of market creation will become an even lower test than that of art.114 TFEU. This is arguably the case even if the post-*Tobacco Advertising* cases³⁰ have similarly confirmed the European preference for "when in doubt legislate" by not paying much tribute to the legislative limits as set by the Treaties: namely conferral, subsidiarity and proportionality. Yet there is a further possible candidate here, not mentioned by the Commission, namely art.325 TFEU (ex art.280). This provision stipulates that the Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union through measures to be taken in accordance with this article, which shall act as a deterrent and be such as to afford effective protection in the Member States, and in all the Union's institutions, bodies, offices and agencies. Admittedly, as Mitsilegas points out, it is not clear whether the Union would have competence under art.325 TFEU to adopt criminal laws on fraud or whether it would need to have recourse to art.83(2) TFEU also.³¹ But likewise, it is not clear why art.325 TFEU is not relevant to the fight against market abuse. Regardless, the Commission seems to be of the view that art.83(2) TFEU is sufficient as a sole legal basis even if the measure is aimed at confidence building in the market.

Of course, from a Member State perspective, there is merit with respect to engaging art.83(2) TFEU as compared with action taken under art.114 TFEU, in that the former provision grants the possibility for the Member States to pull an emergency brake if a proposed measure appears to be too sensitive for the national law criminal law system. Moreover, use of art.114 or art.325 TFEU would mean that the United Kingdom and Ireland would not be able to "cherry-pick" the possibility of opt-outs as they otherwise would regarding legislation within the AFSJ (in accordance with Protocol 21).³² Regardless, it does not answer the question as to what extent it should be possible to use art.83(2)

²⁸ *italics on>* Commission v Council (C-176/03) [2005] E.C.R. I-7879; [2005] 3 C.M.L.R.20 at [47] - [48].

²⁹ M. Aitken, "Measuring market integrity", Nasdaq omx, <http://www.nasdaqomx.com/digitalAssets/71/71132feas-measuringmarketintegrity.pdf> [Accessed July 5, 2012].

³⁰ *Germany v Parliament and Council* (C-376/98) [2000] E.C.R. I-8419; [2000] 3 C.M.L.R. 1175; *Vodafone v Secretary of State for Business, Enterprise and Regulatory Reform* (C-58/08) [2010] 3 C.M.L.R. 44; see S. Weatherill, "The limits of legislative harmonisation ten years after Tobacco Advertising: how the court's case law has become a 'drafting guide'" (2011) 12 *German Law Journal* 827.

³¹ V. Mitsilegas, *EU Criminal Law* (Oxford: Hart Publishing, 2009), Ch.2.

³² Protocol 21 attached to the Lisbon Treaty. According to arts 1 and 3 of this Protocol, the United Kingdom and Ireland do not take part in legislation adopted within the AFSJ unless they opt to participate in such legislation by notifying the President of the Council in writing within three months after a proposal or initiative has been presented to the Council.

TFEU to legislate for confidence in the market, the merits of the emergency brake notwithstanding.

Would Article 114 TFEU have been a better legal basis?

It could cautiously be asked if the Commission will from now on be able to achieve the adoption of legislation relating to the internal market more easily under art.83(2) TFEU than art.114 TFEU. As explained, the proposed Directive claims to be boosting confidence in the market and ensuring investor protection, and it uses the same arguments as are usually applied under art.114 TFEU. The rationale for prohibiting insider dealing and market manipulation is to prevent market failure.³³ Manipulative practices are a form of market failure, which ultimately leads to an inefficient allocation of resources and damages the marketplace in capital allocation. In connection with the 2003 MAD, Moloney pointed out that although that Directive did not directly address the link to the removal of obstacles to trade or distortion of competition, it was concerned with the integrated market place against new integration risks. According to Moloney, control of these risks should, given the particular investor protection and market integrity needs of the integrated investment services and security marketplace, be accommodated within the art.114 TFEU "functioning of the market place requirement".³⁴ So it could be argued that market abuse undermines trust in the market. Yet, as explained, the Directive is based on art.83(2) TFEU not art.114 TFEU.

In addition, it is worth asking if it would be desirable to have a dual legal basis for the adoption of the Directive or whether such an approach would lead to a legal basis conflict. Typically, a dispute of conflicting legal basis has been resolved by recourse to the centre of gravity test.³⁵ As regards art.114 TFEU, there is however no real centre of gravity test available, the question resting rather on whether the measure at issue contributes to market creation at all.³⁶ Consequently, it could be argued that the proposed Directive could have been based on art.114 TFEU if a sufficiently strong market creation link could be demonstrated (which, in any event, seems largely absent under art.83(2) TFEU).

Moreover, the market abuse regime has many similarities to the Third Money Laundering Directive,³⁷ in that it aims to create confidence in the market but does not really explain why. The Third Money Laundering Directive is based on art.114 TFEU and involves administrative sanctions. Interestingly, market abuse forms part of the money laundering framework in some Member States such as the United Kingdom.³⁸ It remains unclear how the relationship between these instruments will develop in the future.

The proposed Regulation: competition law through the back door?

The proposed Regulation³⁹ addresses the same area but its regime is stricter than that proposed by the Directive. Most interestingly, it appears to bring competition law in through the back door by granting far-reaching surveillance mechanisms and by introducing so-called (black)listing, discussed below. The proposed Regulation is closely associated with reform of the so-called MiFD (Markets in Financial Instruments Directive) and is suggested to enter into force on the date of entry into application of the MiFID review.⁴⁰ Hence the proposal follows the Commission's Communication "Ensuring efficient, safe and sound derivatives markets: Future policy actions", where the Commission undertook to extend relevant provisions of the MAD in order to cover derivatives markets in a comprehensive fashion.⁴¹

As for the legal basis of the proposed Regulation, the Commission states that:

"There is a need to establish a uniform framework in order to preserve market integrity and to avoid potential regulatory arbitrage as well as to provide more legal

³³ Moloney, *EC Securities Regulation* (2008), p.931.

³⁴ Moloney, *EC Securities Regulation* (2008), p.943.

³⁵ *Commission v Council* (C-300/89) [1991] E.C.R. I-2867; [1993] 3 C.M.L.R. 359.

³⁶ e.g. M. Ludwigs, "Annotation C-380/03" (2007) 44 C.M.L. Rev. 1159.

³⁷ Directive 2005/60 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing [2005] OJ L309/15.

³⁸ R. Alexander, *Insider Dealing and Money Laundering in the EU: Law and Regulation* (Aldershot: Ashgate, 2007), p.156.

³⁹ *Proposal for a Regulation on insider dealing and market manipulation* COM(2011) 651.

⁴⁰ Directive 2004/39 on markets in financial instruments [2004] OJ L145/1.

⁴¹ European Commission, "Ensuring efficient, safe and sound derivatives markets" COM(2009) 332 (July 3, 2009).

certainty and less regulatory complexity for market participants.”⁴²

Hence the justification for the adoption of the Regulation is the same as for the proposed Directive, albeit with a different legal basis, namely art.114 TFEU. The Regulation aims expressly at contributing to the smooth functioning of the internal market.

Why, then, the need for this dual approach with both a Directive and a Regulation to fight market abuse? It is true that the use of double procedures follows a similar pattern to that of anti-money laundering policy, mentioned above (where the main instrument in this area is the Third Money Laundering Directive,⁴³ also based on art.114 TFEU, which is complemented by Regulation 1889/2005⁴⁴ concerning the control of cash entering and leaving the Union) and is intended to supplement the Money Laundering Directive. So it is not the first time that the EU legislator has used a dual legal basis approach. It should be recalled that A.G. Kokott, in her Opinion in the Smoke Flavouring case,⁴⁵ argued that as long as a measure merely serves as a whole to approximate the laws of the Member States, it can provide for procedures that do not bring about approximation directly but by multi-level stages with intermediate steps.⁴⁶ The court agreed and stated that the authors of the Treaty intended to confer on the Union legislature a discretion, depending on the general context and the specific circumstances of the matter to be harmonised, as regards the harmonisation technique most appropriate for achieving the desired result. Regardless, it could be argued that this multi-level approach leads to unnecessary complexity and is not, therefore, in line with the “less is more”-better and smarter regulation-mantra in EU law.

Sanctions: double procedures?

In addition, the proposed Regulation introduces administrative sanctions by stipulating that financial markets are increasingly integrated in the Union and offences can have cross-border effects. The existing divergent sanctioning regimes among Member States foster regulatory arbitrage and impair the ultimate objectives of market integrity and transparency within the single market for financial services. It could seriously be questioned if dual regulation through criminal law sanctions and administrative sanctions, as proposed in the Regulation and the Directive respectively, breaches the principle of *ne bis in idem* or double jeopardy, and thereby art.50 of the Charter of Fundamental Rights. Article 50 states that:

“No one shall be liable to be tried or punished again in criminal proceedings for an offence for which he or she has already been finally acquitted or convicted within the Union in accordance with the law.”

Traditionally, the notion of *ne bis in idem* only applies to criminal law. Yet it could be argued that such an approach leads to a fundamentally unfair system and that the proportionality principle has an important role to play here so as to avoid double procedures. Interestingly, the draft Regulation claims in its Preamble (at Recital 39) that it respects the principles laid down in the Charter and thereby also *ne bis in idem* with regard to sanctions in the Regulation, but nothing is said as regards the relationship between the proposed Directive and the Regulation in this regard. It is to be hoped that the principle of proportionality will play a key role here in order to avoid double sanctions.

Indeed, as one Advocate General recently expressed it in the pending case of *Åkerberg Fransson* concerning the compatibility of the Swedish tax system with the imposition of non-penal sanctions against tax fraud,

“the principle of proportionality and, in any event, the principle of the prohibition of arbitrariness, as derived from the rule of law which results from the common constitutional traditions of the Member States, precludes a criminal court from

⁴² Proposal for a Regulation on insider dealing and market manipulation COM(2011) 651, p.15, para.4.

⁴³ Directive 2005/60 OJ L309/15.

⁴⁴ Regulation 1889/2005 on controls on cash entering or leaving the Community [2005] OJ L309/9, based on a Proposal from the Commission [2002] OJ C227/574.

⁴⁵ *United Kingdom v Parliament and Council* (C-66/04) [2005] E.C.R. I-10553; [2006] 3 C.M.L.R. 1.

⁴⁶ Opinion of A.G. Kokott in *United Kingdom v Parliament and Council* (C-66/04) [2005] E.C.R. I-10553 at [26]-[40].

exercising jurisdiction in a way which completely disregards the fact that the facts before it have already been the subject of an administrative penalty.”⁴⁷

So the Advocate General put his trust in the notion of proportionality as an extra safeguard against double procedures.

Market abuse raids?

A further matter of interest put on the table by the Regulation is the proposed regime for so-called “blacklisting” through the publication of sanctions and by allowing competent authorities far-reaching powers similar to those of competition law raids and anti-terrorism measures. It could be argued that the Regulation brings us very close to the area of competition law, by imposing (as outlined in arts 1215 of the Regulation) an obligation on issuers of financial instruments to issue so-called listing of companies or individuals engaged in market abuse. Furthermore, it authorises and empowers competent authorities, required to be set up by the Member States (art.16) for the purposes of the Regulation, to access telephone and existing data traffic records held by a telecommunications operator or by an investment firm. Accordingly, competent authorities should be able to require these records where a reasonable suspicion of market abuse exists. Competent authorities are furthermore required to report suspicious activity, something that has been highly controversial in connection with the Third Money Laundering Directive, which introduced this mechanism in line with a risk-based approach.⁴⁸ In that context with respect to money laundering, private actors, such as lawyers and banks, are expected to make risk assessments of their customers and divide them into low-risk and high-risk categories.⁴⁹ The rationale for actively engaging the private sector in the anti-money laundering process is to make these actors collect the appropriate information. The reference to a risk-based approach is, however, absent in the MAD context. But it could be argued that this is what is really at stake here. Risk would then be taken as meaning the development of a preventive approach to the area of crime. And “preventive” would be taken as meaning: it is better to legislate before it is too late to save Europe from the current financial turmoil.

Delicate questions raised by the Directive and the Regulation

It appears as if the Commission has kept the cake and eaten it by using two different legislative measures to regulate the same issue, albeit through different means. Yet the critical concepts of market manipulation and insider dealing are not defined in the same way in the Directive and the Regulation respectively, and this might be problematic. The definition in the Regulation is far more complex as compared with the Directive, and it is much longer. It covers a broader area as compared to the current regime under the MAD also to include information that has not been disclosed yet but can still be abused (such as the conditions under which financial instruments will be marketed). The proposed Regulation also states that the increased trading of instruments across different venues makes it more difficult to monitor for possible market abuse. The following sections will address some of the likely controversies that will be generated if both measures are adopted as proposed.

What kind of sanctions?

In the Ship-Source Pollution case, the court of Justice held that the level of criminal law sanctions should be left to the Member States.⁵⁰ Nonetheless, this approach appears now revised by the proposed Directive. Accordingly, the Commission states that:

“Minimum rules on criminal offences and on criminal sanctions for market abuse, which would be transposed into national criminal law and applied by the criminal justice systems of the Member States, can contribute to ensuring the effectiveness of this Union policy by demonstrating social disapproval of a qualitatively different

⁴⁷ Although the Advocate General argued that the interpretation of the national rules in question did not fall within the strict requirement of “implementation of EU law” under art.51 of the Charter: see *Klagaren v Kerberg Fransson* (C-617/10), Opinion of A.G. Cruz Villalón, June 12, 2012 at [95].

⁴⁸ See e.g. V. Mitsilegas and B. Gilmore, “The EU legislative framework against money laundering and terrorist finance: a critical analysis in the light of evolving global standards” (2007) 56 *International and Commercial Law Quarterly* 119.

⁴⁹ Directive 2005/60 [2005] OJ L309/15.

⁵⁰ *Commission v Council* (C-440/05) [2007] E.C.R. I-9097; [2008] 1 C.M.L.R. 22

nature compared to administrative sanctions or compensation mechanisms under civil law. Criminal convictions for market abuse offences, which often result in widespread media coverage, help to improve deterrence as they demonstrate to potential offenders that the authorities take serious enforcement action which can result in imprisonment or other criminal sanctions and a criminal record.”⁵¹

This appears to indicate a high minimum level for the relevant penalties.

The Commission's Communication on reinforcing sanctioning regimes in the financial sector is particularly intriguing in this context.⁵² It is stated there that efficient and sufficiently convergent sanctioning regimes are the necessary corollary to the new supervisory system and that:

“Supervision cannot be effective with weak, highly variant sanctioning regimes. It is essential that within the EU and elsewhere, all supervisors are able to deploy sanctioning regimes that are sufficiently convergent, strict, resulting in deterrence.”

Nonetheless, nothing is said about the type of sanctions to be adopted. Regardless, in the proposed Directive, the Commission argues that criminal sanctions, in particular imprisonment, are generally considered to send a strong message of disapproval that could increase the dissuasiveness of sanctions, provided that they are appropriately applied by the criminal justice system.⁵³ However, in the Communication on reinforcing sanctioning regimes in the financial sector, the Commission also stated that criminal sanctions may not be appropriate for all types of violations. Moreover, it stated that it would assess whether and in which areas the introduction of criminal sanctions, and the establishment of minimum rules on the definition of criminal offences and sanctions, may prove to be essential in order to ensure the effective implementation of EU financial services legislation. This is unfortunately not the case in the Directive.

Attempts

Both instruments cover attempted manipulation and attempted insider dealing. The proposed Regulation provides in arts 7 and 8 that attempting to engage in insider dealing or market manipulation is prohibited, while the Directive simply states (in arts 3 and 4) that an attempt to engage in market manipulation or insider dealing shall be prohibited. It is difficult to see how attempts should be part of the Regulation too when that measure concerns administrative sanctions. After all, where do you draw the line for attempts here as regards when an attempt is started? It should be noted that the law on attempts is controversial in criminal law more generally and under ongoing debate as regards how much subjectivity can be brought into criminal law. Certainly, the law of attempts is fascinating, also from a normative point of view with the so-called subjective versus objective theory debate. According to the latter theory, attempts are “punished” only if they constitute a possible attempt, i.e. a feasible crime. Conversely, according to the subjective theory, an attempt can be punished even if the attempt was an impossible attempt, i.e. impossible to carry out, but where the offender thought that he or she was committing a crime.⁵⁴

So will we see a new European law on attempts emerging? Neither the Regulation nor the Directive offers any clarification as regards the boundaries of attempt. In an oversimplified way, both instruments state that no one shall attempt to engage in market abuse. At best this will mean that it is left to the Member States to use their own national systems as regards how to delineate attempted market abuse; at worst it will lead to divergence in the application of the measures and the Commission will soon “attempt” to issue its own theory on how to view attempts within the scope of EU criminal law. As pointed out by Peers, however, the court has already ruled in *Ebony Maritime*⁵⁵ that to ensure the “effective prevention” of breaches of EC sanctions against former Yugoslavia extended the European regime to cover attempts also.⁵⁶ Moreover the PIF convention⁵⁷ in connection with fraud against the EU budget included incomplete offences within its

⁵¹ *Proposal for a Directive on criminal sanctions for insider dealing and market manipulation* COM(2011) 654 final, p.3.

⁵² *Reinforcing sanctioning regimes in the financial sector* COM(2010) 716 final.

⁵³ *Reinforcing sanctioning regimes in the financial sector* COM(2010) 716 final p.13.

⁵⁴ A. Duff, *Criminal Law Attempts* (Clarendon Press, 1996). See also Herlin-Karnell, “Is there more to it than the fight against Dirty Money?” (2008) 19 E.B.L. Rev. 558.

⁵⁵ *Ebony Maritime SA v Prefetto della Provincia di Brindisi* (C-177/95) [1997] E.C.R. I-1111; [1997] 2 C.M.L.R. 24.

⁵⁶ Peers, *EU Justice and Home Affairs* (2011), p.797.

⁵⁷ PIF Convention [1995] OJ C316/48, discussed in Peers, *EU Justice and Home Affairs* (2011), pp.795-798.

scope, which arguably confirms the existence of the subjective theory in EU criminal law.

Criminal liability for legal persons

The proposed Directive imposes criminal liability on legal persons. The problem is that not all Member States recognise criminal liability for legal persons, but it has been observed that there are a number of examples in secondary legislation already where Member States are required to impose penalties on both natural and legal persons.⁵⁸ Interestingly, the proposal for a Directive on sanctions against employers of illegally resident third-country nationals, based on ex art.63(3)(b) EC, also provides for the obligation to impose criminal sanctions on natural and legal employers.⁵⁹ There are, however, differences between the Member States when it comes to the issue of criminal liability for legal persons. Suffice it to say in the present context that EU law usually recognises this tension and hence leaves it to the Member States to decide what sanctions to impose. The Court has so far recognised this sensitivity by stating that the Member States are free to choose whether to enforce liability on legal persons as long as effective, proportionate and dissuasive sanctions are imposed on someone.⁶⁰ The proposed Directive ignores this sensitive question by simply requiring that there be effective criminal law sanctions against legal persons. Therefore it is reasonable to believe that those Member States who do not recognise such liability at present will have to adapt their systems in the light of the changing EU approach.⁶¹

Data protection and fundamental rights

Adequate protection of personal data and applicable human rights standards offer further delicate questions. The proposed Regulation imposes a very far-reaching supervisory regime by stating that telephone and data traffic records from telecom operators constitute crucial (and sometimes the only) evidence to detect and prove the existence of market abuse. Yet this seems contradictory in the light of the changes brought by the Lisbon Treaty and the Stockholm Programme. For example, the question of data protection in the criminal law context plays a central role in the Stockholm Programme, where it is repeatedly stressed that the framework for data protection needs to be strengthened. The most important change from Lisbon in this regard is the inclusion of art.16 TFEU. That provision not only contains an individual right for the data subject to the protection of his or her personal data, but it also obliges the European Parliament and Council to provide for data protection in all areas of European Union law.⁶² Article 16 TFEU mirrors art.8 of the Charter of Fundamental Rights, which also proclaims the right to data protection. In addition, Declaration 21 attached to the Lisbon Treaty states that specific rules on the protection of personal data and the free movement of such data in the fields of judicial co-operation in criminal matters and police co-operation based on art.16 TFEU may prove necessary because of the specific nature of these fields.

More generally, the prevention of crime in the European Union offers an example of security issues put to the test in the context of the protection of human rights and personal data.⁶³ Recently, the Commission proposed a Directive on the protection of personal data processed for the purposes of prevention, detection, investigation or prosecution of criminal offences and related judicial activities.⁶⁴ This Directive sets out a far-reaching requirement for the Member States to observe and respect personal data, as well as rules for how to collect such data and rules relating to processing of personal data for the purposes of prevention, investigation, detection or prosecution of criminal offences or the execution of criminal offences. The scope of the Directive is not limited to cross-border data processing but applies to all processing activities carried out by "competent authorities". It is tentatively suggested that the proposed market abuse Regulation conflicts with the proposed Directive or at least does not consider its requirements in sufficient detail.

⁵⁸ Peers, *EU Justice and Home Affairs* (2011), Ch.10.

⁵⁹ *Proposal for a Directive of the European Parliament and of the Council providing for sanctions against employers of illegally staying third-country nationals* COM(2007) 249 final. See e.g. O. Lynsky and A. Dawnes, "The ever longer arm of EC law: the extension of Community law into the field of criminal law" (2008) 45 C.M.L. Rev. 131.

⁶⁰ *Belgium v Vandevenne* (C-7/90) [1991] E.C.R. I-4371; [1993] 3 C.M.L.R. 608.

⁶¹ See E. Herlin-Karnell, *The Constitutional Dimension of European Criminal Law* (Oxford: Hart Publishing, 2012), Ch.6.

⁶² H. Hijmans and A. Scirocco, "Shortcomings in EU Data Protection in the Third and Second Pillars: Can the Lisbon Treaty Help Close the Gap?" (2009) 46 C.M.L. Rev. 1485.

⁶³ *Safeguarding Privacy in a Connected World A European Data Protection Framework for the 21st Century* COM(2012) 9 final.

⁶⁴ *Proposal for a Directive on the protection of personal data processed for the purposes of prevention, detection, investigation or prosecution of criminal offences and related judicial activities* COM(2012) 10/3.

This brings us to a closely associated question, namely that of proportionality.

Breach of proportionality?

In the proposed Regulation, the Commission points out that the Charter of Fundamental Rights establishes some important exceptions in art.52 to the application of the rights granted by the Charter and, as such, the right to privacy and to an effective remedy. Article 52 makes it clear that:

"Any limitation on the exercise of the rights and freedoms recognized by this Charter must be provided for by law and respect the essence of those rights and freedoms. Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognized by the Union or the need to protect the rights and freedoms of others."

So under the Charter, unlike the European Convention of Human Rights (ECHR), the general "limitation clause" in art.52 and its proportionality test applies to all rights.⁶⁵ For this reason, the Commission argues that access to data and telephone records is necessary to provide evidence and investigative leads on possible insider dealing or market manipulation, and therefore for the detection and sanctioning of market abuse.

There are two dangers here. First, there is a risk that what will emerge in this area is something similar to a margin of appreciation test as developed in the ECHR case law⁶⁶ and that the proportionality test as set out in art.52 might "lose out" too easily unless strictly applied. Secondly, the Commission seems to forget the existence of art.49 of the Charter, which stipulates that the severity of penalties applied must not be disproportionate to the criminal offence. It is argued that it should be very difficult to derogate from the right to a proportionate penalty as stipulated in art.49 of the Charter as it sets out a different kind of proportionality not really encompassed by art.52. Although it is true that the Regulation does not deal with "criminal law" sanctions, the effect of these sanctions comes very close to that of criminal law and should be regarded as criminal law following the classic Engel criteria. According to these criteria, there should be an autonomous interpretation of sanctions and the consequences of the sanction in question should form the guiding dictum for how to conceptualise it.⁶⁷ Therefore it could be argued that the proposed Regulation breaches proportionality requirements and that art.49 of the Charter should apply also to the sanctions prescribed in the Regulation.⁶⁸

The Commission's vision for a coherent and consistent EU criminal policy

The proposed Directive for criminal law sanctions against market abuse needs to be read in the light of the Commission's recent communications on EU criminal policy. This Communication, "Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law", is particularly interesting as it offers a concrete example in the sphere of EU criminal law of a nuanced debate in the EU's institutions.⁶⁹ This Communication explicitly mentions not only the need to develop a coherent system of EU criminal policy, but also highlights the concerns of EU citizens. Part of the justification for this Communication is, therefore, the added value of EU criminal law, in line with the wishes of the EU citizens. Indeed, a recent Eurobarometer⁷⁰ places the fight against crime high in the EU chart-list of what the citizens want the European Union to tackle effectively. As such, it was ranked fourth after concerns about fixing the debt crises, immigration policy and health policy.⁷¹

In any case, the Commission points out that:

"While EU criminal law measures can play an important role as a complement to the national criminal law systems, it is clear that criminal law reflects the basic values,

⁶⁵ S. Douglas-Scott, "The EU and Human Rights after the Treaty of Lisbon" (2011) 11 *Human Rights Law Review* 645.

⁶⁶ On the margin of appreciation test, see, e.g. M.R. Hutchinson, "The Margin of Appreciation Doctrine in the European Court of Human Rights" (1999) 48 *International and Comparative Law Quarterly* 638, 645.

⁶⁷ *Engel v Netherlands* (A/22) (1979-80) 1 E.H.R.R. 647 ECtHR.

⁶⁸ For a recent strict interpretation of the "Engel test", see Criminal proceedings against Bonda (C-489/10) June 5, 2012, confirming previous case law, e.g. *Kaserei Champignon Hofmeister v Hauptzollamt Hamburg-Jonas* (C-210/00) [2002] E.C.R. I-6453 that administrative sanctions are of a non-criminal law nature.

⁶⁹ COM(2011) 573 final.

⁷⁰ Eurobarometer 75 (Spring 2011), http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75en.htm [Accessed July 5, 2012].

⁷¹ Discussed in E. Herlin-Karnell, "Is the citizen driving the EU's criminal law agenda?" in M. Dougan, N. Nic Shuibhne and E. Spaventa (eds), *Empowerment and Disempowerment of the European Citizen* (Oxford: Hart Publishing, 2012), Ch.9.

customs and choices of any given society.”⁷²

For this reason, the Commission emphasises that it is particularly important to ensure that EU legislation on criminal law, in order to have a real added value—and to be subsidiarity compliant—is consistent and coherent. The question is just what that means. After all, if “consistent and coherent” is always taken to mean “more EU legislation”, then the added value of the Communication is less impressive if the European Union also wants to recognise national identity as promised in the Communication and therefore to respect the principle of subsidiarity. After all, much EU legislation in EU criminal law in general has so far been characterised by “rush” and the need to deal with or respond to specific risks and threats.

The Commission concludes by stating that there should be a common understanding of the guiding principles underlying EU criminal law legislation; such as the interpretation of basic legal concepts used in EU criminal law, and how criminal law sanctions can provide most added value at EU level. If this is seriously embraced in practice, then that is undoubtedly a very welcome development. It is difficult, however, to see how the market abuse initiatives live up to this objective.

In any case, the impact assessment accompanying the proposed instruments on market abuse offers a further intriguing example of a more ambitious approach by the Commission to the enterprise of EU criminal law policies.⁷³ The Commission stipulates that there is a considerable divergence among the Member States and that it is important that regulation keeps pace with market developments. Yet, although the actual impact assessment and the Commission’s Communication on the coherence and effectiveness of EU law offer a remarkable example of a more nuanced approach to EU criminal policy in general, it is argued that it is not reflected in the market abuse initiatives to the desired extent. This appears to be the case even though the impact assessment attached to the proposed Directive and the proposed Regulation provides an impressive example of better regulation in the AFSJ sphere.

Conclusion

The reform of the market abuse regime should be seen in the light of the reconstruction of the rest of this policy area. It represents an attempt to solve the current financial crises by using the criminal law to boost investor confidence.

In addition, it offers a first example of use of art.83(2) TFEU and confirms the wide-ranging scope of the provision. This article has argued that the new Directive on criminal law sanctions against market abuse should not have been based on art.83(2) TFEU but on art.114 TFEU and art.325 TFEU, possibly in conjunction with art.83(2) TFEU. But most importantly, there is no compelling reason for having a Directive and a Regulation regulating the same area. The fight against market abuse is about regulating market failure. If art.83(2) will be used as a short-cut for market creation in the future then there is a reason to be worried. In addition, it is highly debatable whether insider dealing is better fought through criminal law. There is an ethical dimension here that needs to be discussed. If it is acceptable that naming and shaming companies will lead to better convergence through administrative sanctions, as suggested in the Regulation, then why is it also necessary to add criminal law to the picture? It is tentatively suggested that the Commission neglected to consider its own promise in its Communication “Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law”, that subsidiarity and consistency play an increasingly important role with respect to legislation adopted within the AFSJ.

Finally, the proposed Regulation raises important issues as regards how much prevention can be achieved through the enactment of administrative sanctions. Ideally, the Commission would redraft its proposed legislation to include a better explanation as to why banning market manipulation drives and recovers the European market, and why it needs to be done through double procedures.

So while the European Union is getting tough on white-collar crime and aims for greater market integrity, that very integrity seems still largely in the making.

⁷² Eurobarometer 75 (Spring 2011), p.3 <http://ec.europa.eu/publicopinion/archives/eb/eb75/eb75.en.htm> [Accessed July 5, 2012].

⁷³ Commission Staff Working Paper, “Impact assessment accompanying the proposals for a Regulation and a Directive on market abuse” SEC(2011) 1217 final, available at <http://ec.europa.eu/internalmarket/securities/docs/abuse/SEC2011.1217.en.pdf> [Accessed July 16, 2012].